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Securing Crypto: Exempting Certain Cryptoassets from the Arkansas Securities Act

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SECURING CRYPTO: EXEMPTING CERTAIN CRYPTOASSETS FROM THE ARKANSAS SECURITIES ACT

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INTRODUCTION

Out of fifty states in 2019, Arkansas was ranked forty-fourth for technology and innovation with a grade of "F," thirty-sixth for economy with a grade of "D+," and thirty-seventh for business friendliness with a grade of "D+."[1] It is time to make Arkansas an innovation and business friendly state. Exempting certain fully functional cryptoassets, those that have some purpose other than a speculative or investment purpose, from the Arkansas Securities Act is one step towards doing so.

This Comment suggests that the Arkansas legislature should adopt an exemption from the Arkansas Securities Act for these cryptoassets. Exempting these cryptoassets from state securities laws would be a step towards establishing an innovation-friendly regulatory environment in the State of Arkansas, and if the State acts quickly, could make Arkansas a leading state in this area.[2] This Comment will provide a brief background on cryptoassets[3] for those new to the topic, including a survey of current

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1. *Top States 2019: Overall Ranking*, CNBC (July 10, 2019), [https://perma.cc/3YJF-EHDG].

2. *See infra* Part III.B.

3. This Comment will refer to "cryptoassets," a term intended to be broader than "cryptocurrencies." Cryptoassets are a digital asset class, defined as "digital assets in which cryptographic techniques are used to regulate the generation of units of the asset and to verify their transfer between parties via a blockchain without a central party," and include more than currency substitutes. *Cryptocurrencies and Cryptoassets: Managing the New Asset Class*, EY, [https://perma.cc/H4UA-5RDJ] (last visited Sept. 9, 2020).

cryptoassets, provide an overview of Arkansas securities regulations, explain why most fully functional cryptoassets likely constitute securities under the Arkansas Securities Act, and survey recent legislation in other states exempting certain cryptoassets from state securities laws. This Comment will then argue that fully functional cryptoassets should be exempted to create greater regulatory certainty and an innovation-friendly regulatory environment to secure capital, jobs, and revenue for the State of Arkansas.

I. WHAT ARE CRYPTOASSETS?

A. Coins versus Tokens

Cryptoassets are a digital asset class whereby "cryptographic techniques are used to regulate the generation of units of the asset and to verify their transfer between parties via a blockchain without a central party."[4] There are thousands of different cryptoassets on the market, over 5,300 as of April 2020.[5] Cryptoassets are usually categorized as either coins or tokens.[6] Coins are native to their own blockchain and often have features that are similar to government backed money, or fiat currency.[7] Digital coins may act as a currency, with no real function other than serving as a way to transfer value, store value, or act as a unit of account[8] and operate "independently of other platforms."[9]

Tokens, by contrast, are created on already existing blockchains, and are often used within the "ecosystem" of a particular project, such as those used within decentralized

4. *Id.*

5. *All Cryptocurrencies*, COINMARKETCAP, [https://perma.cc/6EHK-SA3N] (last visited April 22, 2020).

6. *See* Stephen O'Neal, *Differences Between Tokens, Coins and Virtual Currencies, Explained*, COINTELEGRAPH (July 29, 2019), [https://perma.cc/33JS-3WBM].

7. *Id.*

8. Laura M., *Token vs Coin: What's the Difference?*, BITDEGREE (Sept.. 8, 2020), [https://perma.cc/797D-QRJL].

9. Carol Goforth, *The Lawyer's Cryptionary: A Resource for Talking to Clients About Crypto-transactions*, 41 CAMPBELL L. REV. 47, 66 (2019) (citing *Difference Between Cryptocurrency Coins and Tokens*, CRYPTONIAM (Dec. 5, 2017), [https://perma.cc/9A4W-V77P]).

applications, or "dApps."[10] DApps connect users directly and do not require a middleman to function, as centralized apps like Uber and Gmail do.[11] Ethereum, a popular cryptoasset, allows developers to run dApps on the Ethereum platform, and some have dubbed Ethereum "the Mother of [dA]pps."[12] The Ethereum white paper groups dApps into three primary categories: apps for managing money, "apps where money is involved (but also require[] another piece)", and apps classified as "other," such as those involving "voting and governance systems."[13] Tokens often give the holder the ability to participate in the network and may be used for payment inside the ecosystem, represent shares, or give the holder access to some aspect of the project.[14]

B. Bitcoin

A familiar digital coin is bitcoin. The Bitcoin white paper was published in 2008 by the still anonymous Satoshi Nakamoto.[15] Bitcoin was launched as a peer-to-peer "electronic cash" system based on a cryptographic proof designed to replace professional financial institutions that serve as third-party intermediaries between two transacting parties in conventional transactions.[16] Bitcoin differed from the earlier attempts at creating digital currencies, such as Flooz, Beenz, and Digicash which appeared in the 1990s,[17] because Bitcoin is a peer-to-peer network that uses a proof-of-work protocol,[18] whereas earlier

10. O'Neal, *supra* note 6; Laura M., *supra* note 8.

11. *What is a Decentralized Application?*, COINDESK (July 23, 2020), [https://perma.cc/TQ39-WDWA].

12. *What Are Dapps? The New Decentralized Future*, BLOCKGEEKS, [https://perma.cc/2KKN-6ND3] (last visited Sept. 9, 2020).

13. COINDESK, *supra* note 11.

14. Bonpay, *What Is the Difference Between Coins and Tokens?*, MEDIUM (Mar. 13, 2018), [https://perma.cc/7QQM-4FF5].

15. SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM, (2008), [https://perma.cc/3GUT-9PHB]; *see also* Marie Huillet, *11 Years Ago Today Satoshi Nakamoto Published the Bitcoin White Paper*, COINTELEGRAPH (Oct. 31, 2019), [https://perma.cc/Q3YC-C88Z].

16. *See* NAKAMOTO, *supra* note 15.

17. *What is Cryptocurrency. Guide for Beginners*, COINTELEGRAPH, [https://perma.cc/Q529-TYEU] (last visited Sept. 10, 2020).

18. Proof-of-work protocol is a consensus protocol used in a decentralized, peer-to-peer network like Bitcoin and other early coins. Goforth, *supra* note 9, at 90.

unsuccessful versions used the "Trusted Third Party approach."[19] The reason Bitcoin was considered innovative is that the Bitcoin blockchain solved the "double spend" problem without relying on a trusted third-party intermediary to verify transactions.[20]

The double-spend problem arises because without accurate and trusted record keeping, the same amount can be spent twice by the same holder.[21] Bitcoin relied on an innovative "proof-of-work" consensus protocol to resolve the double-spend issue without third-party intermediaries by allowing participants in the network to verify transactions using blockchain technology to timestamp groups of transactions and broadcast them across the network.[22]

A few terms must be defined in order to understand how this transaction verification process works. Nodes are computers in the network that relay information across the network.[23] Some nodes act as "miners," which serve the important purpose of generating and maintaining the history of bitcoin transactions by solving complex "proof-of-work" math problems.[24] Recent transactions are compiled into blocks and at the end of each block is a complicated math problem that miners work to solve.[25] When a miner solves the problem, the result is two-fold: the block of validated transactions is added to the blockchain and the miner is rewarded with bitcoin, which is the process by which new bitcoins are generated.[26]

In addition to avoiding the problems of having to pay and wait for an intermediary to act, Bitcoin also offers users a certain

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19. COINTELEGRAPH, *supra* note 17. The Trusted Third-Party Approach means that the security protocol is controlled by a third party. Nick Szabo, *Trusted Third Parties are Security Holes*, SATOSHI NAKAMOTO INSTITUTE (2001), [https://perma.cc/7MUW-CAYA].

20. Harsh Agrawal, *What is Double Spending & How Does Bitcoin Handle It?*, COINSUTRA (Nov. 6, 2019), [https://perma.cc/M8KA-HBQR].

21. Team InnerQuest Online, *How Does a Blockchain Prevent Double-Spending of Bitcoins*?, MEDIUM (Aug. 25, 2018), [https://perma.cc/4MB9-76Q8].

22. COINTELEGRAPH, *supra* note 17; Andrew Tar, *Proof-of-Work, Explained*, COINTELEGRAPH (Jan. 17, 2018), [https://perma.cc/77TR-WX5T].

23. Alyssa Hertig, *How Bitcoin Mining Works*, COINDESK (July 8, 2020), [https://perma.cc/95BZ-QU6K].

24. *Id.;* Nolan Bauerle, *How Does Blockchain Technology Work?*, COINDESK (July 19, 2017), [https://perma.cc/RHN6-36BX].

25. Goforth, *supra* note 9, at 89.

26. COINDESK, *supra* note 23.

layer of privacy.[27] While it is true that distributed ledger technology requires that transactions must be public, public keys are anonymous.[28] This means that anyone can see that an amount is being sent between two parties, but the actual identities of the parties remain anonymous.[29]

However, while transacting with bitcoin may not result in the purchaser's name and physical address being made public, their identity can still be determined using information like an IP address.[30] It is probably more accurate to say that bitcoin transactions are pseudo-anonymous.[31] Users wanting to remain truly anonymous have a few options. One way is through a process known as "Bitcoin mixing," which tries to destroy traceability by "creating temporary addresses or by swapping coins with other addresses of the same value."[32] There are other coins which offer greater privacy that will be discussed in the privacy coin section of this Comment.

C. The Emergence of Altcoins

In determining whether cryptoassets are securities, it is necessary to understand that there are various other cryptoassets on the market besides bitcoin.[33] Each of these cryptoassets are distinguishable in a number of important ways.[34] The first cryptoassets that arose after bitcoin were known as "altcoins."[35] Altcoins can differ from bitcoin in many ways, such as by using a different economic model, a different method for distributing coins, a different mining algorithm, by offering "more versatile programming language" so that applications can be built on the

27. *See Protect Your Privacy*, BITCOIN, [https://perma.cc/EAG2-G2SN] (last visited Aug. 27, 2020).

28. NAKAMOTO, *supra* note 15, at 6.

29. *Id.*

30. Harsh Agrawal, *6 Ways To Make Untraceable Bitcoin Transactions*, COINSUTRA (Aug. 12, 2020), [https://perma.cc/5YL7-FZKA].

31. *Id.*

32. *Id.*

33. *See* Bernard Marr, *A Short History of Bitcoin and Crypto Currency Everyone Should Read*, FORBES (Dec. 6, 2017), [https://perma.cc/RM2H-KYBE].

34. *See CryptoAsset Classifications,* INTELLIGENT TRADING FOUND., [https://perma.cc/A7UD-J8BZ] (last visited Aug. 29, 2020).

35. Marr, *supra* note 33.

blockchain, or by offering a greater level of privacy, among others.[36]

These so-called "altcoins," digital coins designed to serve as alternatives to bitcoin, began to emerge in 2011.[37] Altcoins attempted to change and improve on some aspect of the process used in bitcoin transactions, such as by offering increased speed or greater anonymity for users.[38] Some of the first rivals to emerge were Namecoin and Litecoin.[39]

The Ethereum platform was created in 2015 and its native currency is ether.[40] Ether is marketed as "'digital money' that can be sent over the internet instantly and cheaply."[41] Ether is consistently the second most highly capitalized cryptoasset behind bitcoin.[42] Ethereum mining is similar to Bitcoin mining, and "problems" are usually solved every twelve seconds, broadcasting the block across the network for validation and rewarding the successful problem solver with ether.[43] Like Bitcoin, Ethereum is not controlled by a "company or centralized organization" and is instead "maintained and improved over time by a diverse global community of contributors."[44] The Ethereum platform is different from Bitcoin in that it allows developers to build applications and technologies on top of its blockchain.[45]

The Ethereum platform allows for the trading of ether and it uses blockchain-based smart contracts to facilitate these transactions.[46] A smart contract is a computer protocol that digitally facilitates, verifies, or enforces transactions without the

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36. *What Is an Altcoin?*, BITCOIN MAG., [https://perma.cc/CSK4-N8VK] (last visited Aug. 29, 2020).

37. Marr, *supra* note 33.

38. *Id.*

39. *Id.*

40. *See What Is Ether (ETH)?*, ETHEREUM, [https://perma.cc/3AD3-8NTT] (last visited Aug. 29, 2020).

41. *How To Buy Ether (ETH),* MYCRYPTO (July 1, 2020), [https://perma.cc/HX5J-DMZB].

42. *Top 100 Cryptocurrencies by Market Capitalization*, COINMARKETCAP, [https://perma.cc/RCY6-4QM2] (last visited Aug. 31, 2020).

43. Alyssa Hertig*, How Ethereum Mining Works*, COINDESK (July 13, 2020), [https://perma.cc/9Y77-7Q7L].

44. Ethereum, FACEBOOK (June 30, 2020), [https://perma.cc/GGM8-SCDS].

45. COINDESK, *supra* note 11.

46. Marr, *supra* note 33.

need for third parties.[47] A smart contract completes transactions with cryptographic code.[48]

The Arkansas legislature took the step to define a smart contract in 2019,[49] joining a number of other states that have taken similar action.[50] Arkansas law defines a smart contract as "[b]usiness logic that runs on a blockchain; or" "[a] software program that stores rules on a shared and replicated ledger and uses the stored rules for:" "[n]egotiating the terms of a contract;" "[a]utomatically verifying the contract;" "and [e]xecuting the terms of a contract."[51] While it is positive that the Arkansas legislature is looking into the crypto space, this bill received a great deal of criticism from the blockchain community, particularly for specifying that smart contracts are enforceable commercial contracts.[52]

The XRP token is another well-known cryptoasset.[53] XRP is used to transfer value across the Ripple Network, and it acts as a mediator for crypto and fiat currency exchanges.[54] Ripple markets itself as a global payments network that "enable[s] financial institutions to send money across borders, instantly, reliably and for fractions of a penny."[55] Ripple uses its own unique patented technology, the Ripple protocol consensus algorithm (RPCA), to facilitate transactions.[56] Whether it is appropriate to classify the XRP token as a cryptoasset is controversial.[57] Some have argued that Ripple is not a true

47. Ameer Rosic, *Smart Contracts: The Blockchain Technology That Will Replace Lawyers*, BLOCKGEEKS, [https://perma.cc/D5WV-B5XZ] (last visited Sept. 11, 2020).

48. Alyssa Hertig, *How Do Ethereum Smart Contracts Work?*, COINDESK (July 13, 2020), [https://perma.cc/5BSF-DYNW].

49. ARK. CODE ANN. § 25-32-122 (2019); H.B. 1944, 92d Gen. Assemb., Reg. Sess. (Ark. 2019).

50. Jonathan A. Beckham & Maria Sendra, *Smart Contracts Lead the Way to Blockchain Implementation*, GREENBERG TRAURIG 2 (Dec. 2, 2019), [https://perma.cc/8JXX-76ET].

51. ARK. CODE ANN. § 25-32-122; Ark. H.B. 1944.

52. *See infra* Part II.D.ii.

53. *What Is Ripple. Everything You Need to Know*, COINTELEGRAPH, [https://perma.cc/ZLX8-GKVU] (last visited Sept. 2, 2020).

54. *Id.*

55. *Our Company*, RIPPLE, [https://perma.cc/74EJ-4VTW] (last visited Apr. 22, 2020).

56. COINTELEGRAPH, *supra* note 53.

57. Joe Liebkind, *Why Some Claim Ripple Isn't a 'Real' Cryptocurrency*, INVESTOPEDIA (Dec. 24, 2017), [https://perma.cc/YYC8-FE84].

cryptoasset at all because it is not decentralized and is instead controlled by one company.[58]

In fact, because of the central role the Ripple company plays in the control and maintenance of the XRP tokens, plaintiffs in a California class action have alleged that XRP tokens are securities and Ripple violated state and federal securities laws by failing to register XRP offerings with the State of California or the SEC.[59] Supporting plaintiff's proposition is the fact that Ripple has a great deal of control over the flow of XRP because Ripple owns the majority of XRP tokens and chooses when to release them from its escrow service,[60] and due to Ripple's 2014 implementation of what is known as the "balance freeze" feature.[61] This feature allows Ripple to freeze or confiscate XRP from any user, a feature apparently created to aid compliance with regulatory actions such as a court-ordered confiscation of funds.[62] Ripple's motion to dismiss the case was denied on February 26, 2020, so it remains possible that XRP could be classified as a security under state or federal law.[63]

D. Privacy Coins

Some cryptoassets are specifically designed to offer users optimal privacy and anonymity.[64] One such privacy coin is monero.[65] Monero markets itself as "electronic cash that allows fast, inexpensive payments to and from anywhere in the world."[66] The Monero ledger allows users to send and receive transactions

58. Mix, *Ripple (XRP) Is Centralized and Terribly Flawed, Researchers Say*, HARD FORK (Feb. 6, 2018), [https://perma.cc/YYF4-F57T].

59. Zakinov v. Ripple Labs, Inc., 369 F. Supp. 3d 950, 952 (N.D. Cal. 2019).

60. Stephen O'Neal, *XRP Fork Unlikely to Succeed, Ripple Continues to Face Angry Investors*, COINTELEGRAPH (Sept. 15, 2019), [https://perma.cc/97KJ-K642].

61. *The Ripple Story*, BITMEX RESEARCH 6 (Feb. 6, 2018), [https://perma.cc/7GXX-RQQL].

62. *Id.*

63. Zakinov v. Ripple Labs, Inc., No. 70, slip op. at *23 (N.D. Cal. Feb. 26, 2020).

64. Taylor Armerding, *IMF Wants to Pierce the Blockchain Anonymity Veil*, SYNOPSYS (Apr. 3, 2018), [https://perma.cc/8MB7-2MWP].

65. *Id.*

66. *What Is Monero (XMR)?*, MONERO, [https://perma.cc/PE89-JRT6] (last visited Apr. 22, 2020).

and no one else can see the sender, amount, or the destination.[67] It is virtually impossible to link monero to previous transactions because sending and receiving addresses are hidden in every Monero transaction.[68]

Zcash is another popular privacy coin.[69] Zcash shields addresses and balances from being visible on the blockchain.[70] One difference between Monero and Zcash is that all Monero transactions are private, whereas Zcash allows the user to choose if their address or transaction is transparent.[71] Zcash users choose whether or not the sender and recipient are private or public.[72] There are a number of additional differences between Monero and Zcash regarding their underlying protocols, cryptography, and the way each is mined[73], but both are classified as privacy coins.[74]

E. Stablecoins

Stablecoins are cryptoassets that are tied to another fungible asset, such as fiat currencies like the U.S. dollar, or other established cryptoassets.[75] Pegging a cryptoasset to another asset is done for the purpose of stabilizing price volatility.[76] Bitcoin is not backed by any other currency, any government, or any other asset, and its value is volatile as a result.[77]

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67. Aaron Mangal, *What Is Monero (XMR)? An In-Depth Guide to the Privacy Coin*, COINCENTRAL (Jan. 9, 2019), [https://perma.cc/H67P-W83N].

68. *See* MONERO, *supra* note 66.

69. Rajarshi Mitra, *Zcash vs. Monero: Comparative Privacy Coin Guide*, BLOCKGEEKS, [https://perma.cc/FDR6-2JEH] (last visited Sept. 11, 2020).

70. *The Basics*, ZCASH, [https://perma.cc/FM7U-FDLA] (last visited April 22, 2020).

71. *Id.*; Mitra, *supra* note 69.

72. Mitra, supra note 69; ZCASH, *supra* note 70.

73. For more information regarding the technical differences between Zcash and Monero, see Mitra, *supra* note 69.

74. *See id.*

75. Connor Blenkinsop, *Stablecoins, Explained*, COINTELEGRAPH, (Apr. 30, 2019) [https://perma.cc/EQ5K-J684].

76. *Id.*

77. *See* COINMARKETCAP, *supra* note 5, for information on the value of bitcoin and other cryptocurrencies over time. For a material example of just how volatile bitcoin prices can be, look no further than the "Bitcoin pizza guy," Laszlo Hanyecz, who infamously purchased two Papa John's pizzas for 10,000 Bitcoin in 2010. That 10,000 Bitcoin, which was worth pennies in 2010, has been worth as much as eighty million dollars in recent years. Molly Jane Zuckerman, *Bitcoin Pizza Guy: Laszlo Hanyecz on Why Bitcoin Is Still the Only Flavor of Crypto for Him*, COINTELEGRAPH (May 27, 2018), [https://perma.cc/8G4D-3Z9W].

In many ways, stablecoins aim to be more like the U.S. dollar or other fiat currencies.[78] Stablecoins offer the aspects of crypto that are popular, like transparency, security, speed, low fees, and privacy, while offering the best aspect of traditional payments methods, like trust and stability.[79] There are many potential benefits from adopting stablecoins. A secure digital currency could make cross-border transactions cheaper and more efficient, improve financial planning, and serve as a financial tool for the underbanked.[80]

There are a few different ways to create a stablecoin peg. A company itself could hold the collateral, which are known as collateralized stablecoins.[81] Another option is an algorithmic peg, where a smart contract essentially acts as a central bank and alters the amount of the stablecoin in circulation so that it is always correctly pegged to the underlying asset.[82]

Tether is a popular stablecoin.[83] Tether is marketed as "traditional currency on the Blockchain."[84] Tether can be pegged to U.S. dollars, euros, or Chinese yuans.[85] Reeve Collins, CEO of Tether, described Tether as "a dollar that works on the blockchain."[86] The Tether website states that "[o]ne Tether equals one underlying unit of the currency backing it, e.g., the U.S. Dollar, and is backed 100% by actual assets in the Tether platform's reserve account."[87] Tether periodically publishes a record of its reserve balances.[88]

A proposed stablecoin that has been in recent headlines is libra, the proposed cryptoasset developed by the makers of

78. *What Are Stablecoins?,* CB INSIGHTS 1, [https://perma.cc/NXB8-7ZFX].

79. *Id*. at 2.

80. *Id*. at 3.

81. Ofir Beigel, *The Complete Beginner's Guide to Stablecoins*, 99BITCOINS (May 4, 2020), [https://perma.cc/L84D-BV7M].

82. *Id.*

83. *See* Blenkinsop, *supra* note 75.

84. *Why Use Tether?*, TETHER, [https://perma.cc/224Y-29Y5] (last visited Aug. 28, 2020).

85. *FAQs*, TETHER, [https://perma.cc/GNU4-DSNJ] (last visited Aug. 28, 2020).

86. Pete Rizzo, *Realcoin Rebrands as 'Tether' to Avoid Altcoin Association*, COINDESK (Nov. 20, 2014), [https://perma.cc/BS2Q-7AMX].

87. *About Us*, TETHER, [https://perma.cc/65P3-W3ML] (last visited Sept. 11, 2020).

88. *Transparency*, TETHER, [https://perma.cc/4FER-DKAQ] (last visited Sept. 11, 2020).

Facebook.[89] The original Libra White Paper published in June 2019 said that libra would be pegged to "a basket of global currencies."[90] The white paper was updated in April 2020, now stating that libra will be pegged to singular currencies rather than "a basket of global currencies," largely in response to concerns that libra could affect monetary sovereignty and monetary policy.[91] The problem identified in the Libra White Paper is that "1.7 billion adults globally remain outside of the financial system with no access to a traditional bank" yet one billion people own mobile phones and half a billion have access to the internet, which Libra intends to solve by increasing financial inclusion.[92]

A difference between Libra and many other cryptoassets is that Libra, as proposed, will not be decentralized in the same way as other cryptoassets.[93] The Libra Association is Libra's governing body, described as an independent, not-for-profit organization responsible for "facilitate[ing] the operation of the Libra payment system," coordinating among stakeholders, and managing the Libra Reserve.[94] The Libra Association is made up of many prominent organizations from various industries, including the aforementioned Facebook, which is primarily responsible for generating the project, as well as Lyft, Spotify, Uber, Coinbase, Mercy Corps, and others.[95]

89. Kari Paul, *Libra: Facebook Launches Cryptocurrency in Bid to Shake up Global Finance*, THE GUARDIAN (June 18, 2019), [https://perma.cc/4WN5-GAMY].

90. Richard Meyer, *Facebook Reveals Libra Crypto's Currency Basket Breakdown: Report*, COINDESK (Sept. 23, 2019), [https://perma.cc/VLJ7-FFMZ]; *White Paper*, LIBRA ASS'N 1 (Apr. 2020), [https://perma.cc/L6E5-T33G].

91. LIBRA ASS'N, *supra* note 90, at 1-2.

92. *Id.* at 4.

93. *See id.* at 24.

94. *Id.*

95. *The Libra Association*, LIBRA, [https://perma.cc/79D8-R2L2] (last visited Sept. 1, 2020). However, eBay, Mastercard, Visa, and PayPal, among others, have withdrawn from the Libra project due in part to scrutiny from government regulators. Lauren Feiner, *Facebook's Libra Cryptocurrency Coalition Is Falling Apart as eBay, Visa, Mastercard and Stripe Jump Ship*, CNBC (Oct. 13, 2019), [https://perma.cc/5N7W-62NR].

F. Initial Coin Offerings (ICOs) and Security Token Offerings: A Distinction with Little Difference

An Initial Coin Offering (ICO) is a way for a company marketing a new cryptoasset to raise capital from investors, and the new crypto is usually purchased with fiat money or other existing cryptoassets.[96] J.R. Willett is accredited with holding one of the first ICOs, which was for Mastercoin.[97] Willett presented the concept of an ICO as:

> a bunch of trustworthy guys . . . that people have heard of [who] say, okay, we're going to do this. We're going to make a new protocol layer. It's going to have new features X, Y and Z on top of bitcoin, and here's who we are and here's our plan, and here's our bitcoin address, and anybody who sends coins to this address owns a piece of our new protocol.[98]

In 2013, the Mastercoin ICO raised 5,000 bitcoin, a value of $500,000 at the time.[99]

ICOs are a fundraising mechanism and a way to attract investors to a new crypto project.[100] The way that ICOs often work is that a company will submit a white paper describing the new crypto project and the problem that it is seeking to solve and readers can then decide to invest in the project.[101] When someone invests money in an ICO, they are often providing money for the completion of the project, so it is perhaps more accurate to think of ICOs as an opportunity to invest in the idea of a project rather than investing in the project itself, at least in situations where funds raised go towards project completion.[102] Frequently, the

96. Alibaba Grp. Holding Ltd. v. Alibabacoin Found., No. 18-CV-2897 (JPO), 2018 WL 2022626, at *1 n.1 (S.D.N.Y. April 30, 2018).

97. Chris Abraham, *The Origin Story of the Initial Coin Offering (ICO) Token Sale History*, NEWCONOMY (Oct. 13, 2018), [https://perma.cc/BW7E-TS3U].

98. *Id.*

99. Howard Marks, *The ICO Is Dead. Long Live the ICO 2.0*, HACKERNOON (Feb. 21, 2018), [https://perma.cc/2QPQ-UMN9].

100. Ameer Rosic, *What Is An Initial Coin Offering? Raising Millions in Seconds*, BLOCKGEEKS, [https://perma.cc/A9M2-884M] (last visited Sept. 11, 2020).

101. *Id.*

102. *Id.*

new cryptoassets offered in an ICO are issued for either bitcoin or ether.[103]

ICO's became popular in 2017, a year in which $5.6 billion was raised, catapulting into 2018, where $7 billion was raised in the first quarter alone.[104] ICO popularity took a strong downward tick starting in June 2018.[105] There are a few explanations for why ICO popularity has declined. The first reason is the inherent risks involved in investing in an ICO, which some have called "the new Digital Wild West."[106] One study found that more than eighty percent of ICOs conducted in 2017 were scams.[107] It is pretty simple to create a fraudulent ICO: come up with a fake but conceivable proposal or omit key facts making the proposal seem important and intricate, when in actuality it is not.[108]

Why would someone invest in such a seemingly risky venture? The potential gain is enormous if the coin turns out to be successful.[109] If the coin operates as promised or the value of the coin increases, early purchasers can make significant gains.[110] During the Ethereum ICO, one ether traded for forty to fifty cents.[111] Ether traded for as much as $1,417.38 in 2018, achieving a 13,000% increase in value in that year alone.[112]

Another explanation for the decreasing popularity of ICOs, the most relevant to the scope of this Comment, is the regulatory concerns with ICOs.[113] Perhaps the phrase Initial Coin Offering (ICO) sounds familiar. ICOs are both phonetically and conceptually similar to an Initial Public Offering (IPO), whereby a company sells shares of capital stock to the general public for

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103. *What Is An ICO?*, BITCOIN MAG., [https://perma.cc/4MWW-8R49] (last visited Sept. 11, 2020).

104. *The State of the Token Market 9 Months into 2018*, FABRIC VENTURES 8, [https://perma.cc/9WF5-5A6W] (last visited Sept. 11, 2020).

105. *Id.*

106. Randolph A. Robinson II, *The New Digital Wild West: Regulating the Explosion of Initial Coin Offerings*, 85 TENN. L. REV. 897, 898 (2018).

107. Ana Alexandre, *New Study Says 80 Percent of ICOs Conducted in 2017 Were Scams*, COINTELEGRAPH (July 13, 2018), [https://perma.cc/LG5Y-AGTD].

108. Rosic, *supra* note 100.

109. *Id.*

110. *Id.*

111. *Id.*

112. Arjun Kharpal, *Ethereum Hits a Fresh Record High and Is Up Over 13,000% in a Year*, CNBC (Jan. 10, 2018), [https://perma.cc/YX32-JNZR].

113. Robinson II, *supra* note 106, at 898, 955-56, 960.

the first time.[114] IPOs are securities offerings registered with the Securities and Exchange Commission (SEC).[115]

The SEC has suggested that ICOs often constitute securities offerings, regardless of whether the token or coin itself would constitute a security once it is fully functional.[116] This is because with many ICO investors are providing money for the completion of the project in which offerors continue to play an active role.[117] The SAFT, or Simple Agreement for Future Tokens, Project was a proposal for creating a token sale compliant with securities laws.[118] While the SAFT Project focuses on the federal securities laws and the investment contract test from the United Stated Supreme Court in *SEC v. W.J. Howey Company*,[119] its distinction between pre-functional and functional tokens is pertinent to this Comment:

> Unlike a pre-functional token . . . whose market value is determined predominantly by the efforts of the sellers in imbuing the tokens with functionality, a genuinely functional token's value is determined by a variety of market factors, the aggregate impact of which likely predominates the "efforts of others." Sellers of already-functional tokens have likely already expended the "essential" managerial efforts that might otherwise satisfy the Howey test.[120]

To reiterate the point, even if the token offered would not be considered a security once it is functional, it can be and probably is a security when offered through an ICO, because most ICOs sell pre-functional tokens, or contractual rights to acquire the tokens when they are functional, rather than the actual tokens themselves.[121] ICOs of this sort should be registered with

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114. BITCOIN MAG., *supra* note 103; *Investor Bulletin: Investing in an IPO*, SEC, OFF. OF INV. EDUC. AND ADVOC. 1, [https://perma.cc/FMP4-UCUE] (last visited Aug. 23, 2020).

115. SEC, *supra* note 114, at 1.

116. *See* JUAN BATIZ-BENET ET AL., THE SAFT PROJECT: TOWARD A COMPLIANT TOKEN SALE FRAMEWORK 11 (2017), [https://perma.cc/EQA9-UXVT]; *Spotlight on Initial Coin Offerings (ICOs)*, SEC (Jan. 7, 2020), [https://perma.cc/CCK9-2R52].

117. *See* BATIZ-BENET ET AL., *supra* note 116, at 11.

118. *Id.* at 15.

119. SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

120. *Id.* at 1-2.

121. *See* James J. Park, *When Are Tokens Securities? Some Questions from the Perplexed*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 20, 2018), [https://perma.cc/XN4C-DBY3].

securities regulators and investors need the protection of the securities laws in this space.[122] While this Comment will not focus on how the SEC has regulated cryptoassets and ICOs to date, it is important to understand that the SEC certainly has ICOs on its radar and has found that most ICOs are securities offerings.[123]

Tokenized securities, or security tokens, are cryptoassets that are specifically designed to function like traditional securities.[124] Security tokens represent interests in a business venture and may provide certain rights to investors, including equity, the right to receive dividends, profit-sharing rights, voting rights, etc.[125] Security tokens may be offered through Security Token Offerings (STOs), which are either registered with the relevant securities regulators or structured to comply with an exemption; they are generally understood to be securities by the transacting parties.[126] The label STO is not universally used, with some such offerings still being referred to as ICOs, but in the case of tokenized securities, the term is understood to refer to a legally compliant, licensed distribution, registered with or exempt from registration by the appropriate securities regulators.[127] Security tokens and offerings of security tokens are understood to fit within the current securities laws to the blockchain industry and generally minimize investor risk as compared to noncompliant ICOs.[128]

Many think STOs could serve as the bridge between traditional finance and the blockchain world.[129] While some token creators will want to avoid being classified as securities, there are benefits to being regulated in certain circumstances, such as with security tokens, because they offer investors a

122. *See id.*

123. For more information on how the SEC has regulated crypto, see SEC, *supra* note 114.

124. David Petersson, *What Are Tokenized Securities and Why They Matter*, FORBES (Mar. 27, 2019), [https://perma.cc/H7XH-GM5M].

125. *Id.*

126. *Id.*

127. *See* Tim Fries, *STOs v. ICOs: What's the Difference?*, THE TOKENIST (Sept. 15, 2019), [https://perma.cc/9AMT-HN2X].

128. *Id.*

129. *Id.*

greater level of security, as the "security token" label aptly implies.[130] Legally compliant offerings of security tokens should be encouraged and allowed to flourish. This is a promising way the traditional financial system is adopting this innovative technology.

This Comment will not argue that security tokens should be exempted from the Arkansas Securities Act because they are intended to be securities, gain legitimacy from regulation, and it would not be in the State's or the transacting parties' interests to exempt tokenized securities from state securities laws.[131] This Comment suggests that fully functional cryptoassets other than tokenized securities should be exempted from Arkansas securities laws to ensure that Arkansas is a pro-innovation, pro-technology, and pro-business state.

G. Utility Tokens versus Security Tokens

Some cryptoassets have no function other than serving as a substitute for currency, conventional debt, or equity securities, or they derive their value from an external, tradable asset.[132] These are the kind of tokens that are most often agreed to be subject to securities laws.[133] Some sources lump all of these into the category of "security token," meaning only these tokens should be regulated as securities.[134] Note that tokenized securities, as that phrase is used in this Comment, are one kind of security token, but other kinds of crypto may also be security tokens.[135] The lack of precision in this particular label is one reason that this Comment does not use it.

Lawmakers and writers in the crypto space often have a special category for tokens that are not seen as being within the

130. *Complete Guide to Security Tokens: How They Work Explained Simply*, THE TOKENIST, [https://perma.cc/9M3C-AC6H] (last visited Aug. 24, 2020).

131. *See id*; Fries, *supra* note 127.

132. Toshendra Kumar Sharma, *Security Tokens vs. Utility Tokens: A Concise Guide*, BLOCKCHAIN COUNCIL (Sept. 6, 2019), [https://perma.cc/VZ8S-LJSD]; Katalyse.io, *Security Tokens vs. Utility Tokens - How Different Are They?*, HACKERNOON (Sept. 25, 2018), [https://perma.cc/D7BN-2LMT].

133. Sharma, *supra* note 132.

134. *See* Rajarshi Mitra, *Utility Tokens vs Security Tokens: Learn the Difference - Ultimate Guide*, BLOCKGEEKS, [https://perma.cc/3JSQ-ZUKE] (last visited Sept. 12, 2020).

135. *See id.*

scope of traditional securities laws; these are often referred to as functional utility tokens.[136] These utility tokens, often associated with smart contracts and dApps, have some inherent utility or functionality other than acting as a currency substitute or speculative investment.[137] Utility tokens have been defined as "entity-specific crypto-assets that have some utility within the software application or platform being developed."[138] There are a number of functions which could constitute "utility," including giving users access to the underlying blockchain, access to digital goods, access to a specific good or service, digital representation of a different financial asset (stablecoins), or fundraising.[139] Utility tokens may allow users to pay for specific services like cloud storage or access to an internet browser with no advertisements.[140] Utility tokens are not created to function like investments.[141]

When it comes to how the securities regulators determine if a token is a security, the federal court's approach is governed by the *Howey* investment contract test, and it should be clear that the SEC and the courts will not assume a token is outside of the securities laws just because it is labeled as a utility token.[142] However, there are some useful analogies from the *Howey* case for understanding utility tokens.

In *Howey*, the W.J. Howey Company and Howey-in-the-Hills Service, Inc. were Florida corporations that offered prospective customers land-sales contracts and service contracts

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136. *See, e.g.*, Sharma, *supra* note 132; Nate Crosser, *Initial Coin Offerings as Investment Contracts: Are Blockchain Utility Tokens Securities?*, 67 UNIV. KAN. L. REV. 379, 392-94 (2018); Mitra, *supra* note 134; Rachel Wolfson, *U.S. State Of Wyoming Defines Cryptocurrency 'Utility Tokens' As New Asset Class*, FORBES (Mar. 13, 2018), [https://perma.cc/XYN9-RZSS].

137. Laura M., *supra* note 8.

138. Robinson II, *supra* note 106; *see also* Laura Shin, *Are ICOs for Utility Tokens Selling Securities? Prominent Crypto Players Say Yes*, FORBES (Oct. 2, 2017), [https://perma.cc/Q834-P5UZ].

139. *What Are Utility Tokens, and How Will They Be Regulated?*, SFOX (Dec. 29, 2018), [https://perma.cc/ST7R-UD3E].

140. Park, *supra* note 121.

141. Katalyse.io, *supra* note 132.

142. SEC v. W.J. Howey Co., 328 U.S. 293 (1946); "ICOs, or more specifically tokens, can be called a variety of names, but merely calling a token a 'utility' token or structuring it to provide some utility does not prevent the token from being a security." SEC, *supra* note 114.

for citrus acreage.[143] The Court handed down the famous *Howey* test to determine if an arrangement is an investment contract: an investment contract exists when a person invests money in a common enterprise and expects profits solely from the efforts of a third party.[144]

It is common sense that while the *Howey* contracts were securities under this investment contract test, the Court never held that the tangible oranges themselves constituted securities.[145] In the crypto context, pre-functional tokens[146] offered through ICOs, where money given is used to fund the completion of the project, likely constitute a security offering, but the functional token itself, once completed, is not necessarily a security by virtue of the fact that the ICO constituted a security offering.[147]

However, this Comment does not argue for solely using the utility token versus security token distinction because the labels are so often arbitrarily applied.[148] A token could have some "utility" and nonetheless be considered a security under federal or state law.[149] A pre-functional utility token offered through an ICO is almost certainly a security offering, even though the underlying token might qualify as a "utility token" upon completion.[150] To address this, this Comment instead argues for distinguishing based on functionality for offering exemptions from state securities laws. Once a cryptoasset is functional, it would qualify for an exemption, so long as it is not explicitly marketed on the basis of speculation in value.

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143. *Howey*, 328 U.S. at 294-95.

144. *Id*. at 298-99.

145. Scott Kupor & Sonal Chokshi, *Analogies, the Big Picture, and Considerations for Regulating Crypto*, ANDREESSEN HOROWITZ (May 4, 2018), [https://perma.cc/LY7F-Z9R6].

146. Pre-functional tokens are tokens which do not, at present, have a consumptive use. They are not functional in the way that they will be once the project is complete. *See* BATIZ-BENET ET AL., *supra* note 116, at 11. This distinction between pre-functional and functional tokens matters for the application of the securities laws. "I think almost all pre-functional tokens result in a security per U.S. law," said Marco Santori, a prominent lawyer in the blockchain space. Shin, *supra* note 138.

147. *See* BATIZ-BENET ET AL., *supra* note 116, at 1-2, 9-12; Shin, *supra* note 138.

148. *See supra* Part I.G.

149. SEC, *supra* note 114.

150. *See* Shin, *supra* note 138.

II. ARKANSAS SECURITIES LAWS AND CRYPTO

A. The Arkansas Securities Act

Under the Arkansas Securities Act ("the Act"), there is a long list of arrangements that constitute a security, but the one that matters for the purpose of this Comment is an investment contract.[151] It is unlawful, and a Class D felony in Arkansas, to knowingly offer or sell unregistered and nonexempt securities.[152] It is a Class A misdemeanor to negligently offer or sell unregistered and nonexempt securities.[153] There are also civil penalties involved with the sale of unregistered and nonexempt securities and a buyer of an unregistered and nonexempt security may recover costs and reasonable attorney's fees, plus the consideration paid for the security and six percent interest per year from the date of payment, minus income received from owning the security or damages from the issuer or offeror.[154] Registration of securities in Arkansas requires that numerous documents be filed with the Arkansas Securities Department, along with various fees.[155]

If a cryptoasset meets the definition of an investment contract it is subject to the securities laws and any sale must be registered or exempt.[156] Registration is expensive and

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151. Under the Arkansas Securities Act, a security is:

> any: (i) [n]ote; (ii) [s]tock; (iii) [t]reasury stock; (iv) [b]ond; (v) [d]ebenture; (vi) [e]vidence of indebtedness; (vii) [c]ertificate of interest or participation in any profit-sharing agreement; (viii) [c]ollateral-trust certificate; (ix) [p]reorganization certificate or subscription; (x) [t]ransferable share; (xi) [i]nvestment contract; (xii) [v]ariable annuity contract; (xiii) [l]ife settlement contract or fractionalized or pooled interest in a life settlement contract; (xiv) [v]oting-trust certificate; (xv) [c]ertificate of deposit for a security; (xvi) [c]ertificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or (xvii) [i]n general, any interest or instrument commonly known as a 'security' or any certificate of interest or participation in, temporary or interim certificate for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

ARK. CODE ANN. § 23-42-102 (17)(A) (2019).

152. ARK. CODE ANN. § 23-42-104(b) (1997).

153. ARK. CODE ANN § 23-42-104(c).

154. ARK. CODE ANN. § 23-42-106(a) (2017).

155. *See* ARK. CODE ANN. §§ 23-42-403 to -404 (2011 & 2019) for more information on Arkansas securities registration requirements.

156. *See* Mitra, *supra* note 134.

burdensome and there are a limited number of exemptions.[157] The only presently available alternative is to argue that the cryptoassets in question are not investment contracts, which may be very difficult to do successfully.[158]

The SEC and federal courts use the *Howey* test for investment contracts,[159] which includes any:

> contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[160]

Arkansas, however, follows a different approach.

B. Arkansas's Risk Capital Test

Arkansas courts have taken a more expansive approach to defining an investment contract than the *Howey* test.[161] In Schultz v. Rector-Phillips-Morse, Inc., the Arkansas Supreme Court cited the Hawaii and Minnesota approaches to defining an investment contract.[162] Their approach for determining when an investment contract exists is known as the "risk capital" test. [163] Hawaii holds that an investment contract exists when:

> (1) An offeree furnishes initial value to an offeror, and
>
> (2) a portion of this initial value is subjected to the risks of the enterprise, and
>
> (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and

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157. *See* ARK. CODE ANN. §§ 23-42-403 to -404.

158. *See infra* Part II.B.

159. SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

160. *Id.*

161. Schultz v. Rector-Phillips-Morse, Inc., 261 Ark. 769, 777-78, 552 S.W.2d 4, 8-9 (1977).

162. *Id.* at 779-80, 552 S.W.2d at 9-10.

163. Carol R. Goforth, *Treatment of LLC Membership Interests Under the Arkansas Securities Act*, 1998 ARK. L. NOTES 33, 34-35.

> (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.[164]

In *Schultz*, the Arkansas Supreme Court explained that the definition of an investment contract "should be flexible enough to encompass the endless succession of new and innovative or old and tried promotional schemes, where the promoters, by design, seek to risk the money or property of others in their venture."[165]

The Arkansas Supreme Court also cited the Minnesota Supreme Court, which had previously recognized that the *Howey* test is not the only approach for defining an investment contract.[166] The Minnesota Supreme Court found the *Howey* test to be both "rigid" and "definitive," and acknowledged that while it "is useful in identifying most 'investment contracts,'" the court decided that the *Howey* test should not be the exclusive test for identifying an investment contract in Minnesota.[167] According to the Minnesota court, in a case that preceded the Securities Act of 1933 by thirteen years, the securities laws are a necessary exercise of the state's police powers and should be given a broad construction, "for it was the evident purpose of the Legislature to bring within the statute the sale of all securities not specifically exempted[,]" and "[i]t is better to determine in each instance whether a security is in fact of such a character as fairly to fall within the scope of the statute."[168]

The Arkansas Supreme Court cited this view of the Minnesota Supreme Court approvingly, finding that the definition of a security under the Arkansas Securities Act should not be construed narrowly; rather " it is better to determine in each instance from a review of all of the facts, whether an investment scheme or plan constitutes an investment contract, or a certificate of interest or participation in a profit-sharing agreement, within the scope of the statute."[169]

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164. State v. Haw. Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971).
165. *Schultz*, 261 Ark. at 777, 552 S.W.2d at 8.
166. State v. Invs. Sec. Corp., 209 N.W.2d 405, 410 (Minn. 1973).
167. *Id.*
168. State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920).
169. *Schultz*, 261 Ark. at 781, 552 S.W.2d at 10.

The relevant facts in *Schultz* were as follows: the putative investment contracts were partnership interests in a joint venture organized by the sellers to construct an apartment complex, and it was to be a tax shelter for those who supplied the equity for the project.[170] The court found that the interests in the joint venture were securities under the Arkansas Securities Act.[171]

The venture was merely a tax shelter for the investors; they performed no management duties and had virtually no responsibilities in the operations of the venture.[172] The "[i]nvestors were mere passive contributors of risk capital who placed their money in an investment program" and risked its loss in the venture.[173] The takeaway from *Schultz* is that in Arkansas, a passive investment with hopes of realizing capital gains will constitute a security under the Arkansas Securities Act, because "regardless of labels, the Arkansas Securities Act was designed to protect both investors in common stock and those persons who in substance are the investors in the disguised business venture of another."[174]

Ten years later, in *Casali v. Schultz,* the Arkansas Supreme Court answered a similar question regarding whether the sale of a unit in a partnership interest constituted a security.[175] The sale worked as follows: a group of investors, including the appellees, contributed capital into a partnership to purchase an investment banking house.[176] The sale of the partnership units constituted a security under Arkansas law because the partnership units were, again, a passive investment: the investors could not hire or fire employees, set salaries, mortgage property, open bank accounts, sign checks, incur any debts, sell any assets, or say how the stock would be voted.[177] Like the *Schultz* case, the investors in *Casali* had no management authority in the business, but contributed capital that was subject to the risks of the venture.[178]

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170. *Id.* at 772, 552 S.W.2d at 6.
171. *Id*. at 781, 552 S.W.2d at 10-11.
172. *Id.* at 782-83, 552 S.W.2d at 11.
173. *Id.* at 782, 552 S.W.2d at 11.
174. *Schultz*, 261 Ark. at 777, 552 S.W.2d at 8.
175. Casali v. Schultz, 292 Ark. 602, 603, 732 S.W.2d 836, 836 (1987).
176. *Id.*
177. *Id.* at 604, 732 S.W.2d at 837.
178. *Id.*; *Schultz*, 261 Ark. at 782, 552 S.W.2d at 11.

The court used the risk capital test from *Schultz*, finding that it did not matter that the arrangement was labeled a general partnership interest, but rather the court looked to the "underlying economic substance," or "economic reality," of the arrangement to determine if it was a security.[179] Whether or not a particular arrangement is a security in Arkansas is a "flexible concept" that "should be liberally construed to afford protection to the public."[180]

The Arkansas Court of Appeals has used a slightly varied approach to defining an investment contract. In *Smith v. Arkansas*, the court adopted a five-part test to determine whether a particular purchase constituted an investment contract.[181] Under this test, for a transaction to constitute an investment contract, there must be:

> (1) the investment of money or money's worth;
>
> (2) investment in a venture;
>
> (3) the expectation of some benefit to the investor as a result of the investment;
>
> (4) contribution towards the risk capital of the venture; and
>
> (5) the absence of direct control over the investment or policy decisions concerning the venture.[182]

While the verbiage is different, the Arkansas Supreme Court, as well as the Eighth Circuit, has found that the *Smith* test is "substantially similar" to the *Howey* test the federal courts use.[183] The issue then, is whether the *Schultz* approach and the *Smith* approach are used independently of one other and, if so, when?

The Arkansas Supreme Court has shed some light on this issue in subsequent cases. In *Cook v. Wills*, the court cited the *Smith* five-factor test, but also cited *Schultz* for the proposition

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179. *Casali*, 292 Ark. at 605-06, 732 S.W.2d at 837-38.

180. *Id.* at 605, 732 S.W.2d at 837.

181. Smith v. State, 266 Ark. 861, 865, 587 S.W.2d 50, 52 (Ct. App. 1979). This test was attributed to a law review article written by Professor Joseph Long. *Id* at 864-65; 587 S.W.2d 50, 52*;* Joseph C. Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 OKLA. L. REV. 135, 174 (1971).

182. *Smith*, 266 Ark. at 865, 587 S.W.2d at 52.

183. Union Nat'l Bank of Little Rock v. Farmers Bank, 786 F.2d 881, 885 (8th Cir. 1986); Grand Prairie Sav. & Loan Ass'n v. Worthen Bank & Tr. Co., 298 Ark. 542, 545, 769 S.W.2d 20, 22 (1989).

that "the definition of what constitutes a security must necessarily depend on an analysis of all of the factors in any given transaction."[184] The court did not go into much detail about the different analyses in the *Smith* versus *Schultz* approach, finding that since the plaintiffs provided skill and expertise to the business venture, it could "hardly be categorized as a lack of control" and was enough for the interest not to constitute a security.[185]

A similar result in *Carder v. Burrow*: the court recognized the flexible and broad approach to defining an investment contract under *Schultz*, concluding that the transaction at issue "was an ordinary secured commercial loan" rather than the sale of a security since there was no expectation of "profit."[186] The court seems to take "benefit" to mean "profit," whereas it is plausible, particularly in the crypto context, that a purchaser may receive a "benefit" that would not necessarily be considered a "profit."[187] "Pursuant to the *Smith* factors, investors must expect some 'benefit,' or profit, from the transaction."[188] A benefit could be construed as being broader than a profit, so as benefit has been interpreted to be synonymous with profit, the *Smith* test is narrower than the all-inclusive *Schultz* approach.

The most recent case examining the *Smith/Schultz* approaches to defining an investment contract is *Waters v. Millsap*.[189] In *Waters*, the Arkansas Securities Commissioner argued that the *Smith* test is not the exclusive test for determining if a transaction is a security under Arkansas law, and instead asked the court to adopt the "Family Resemblance Test" that the

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184. Cook v. Wills, 305 Ark. 442, 447, 808 S.W.2d 758, 761 (1991).

185. *Id.*

186. Carder v. Burrow, 327 Ark. 545, 550-51, 940 S.W.2d 429, 432 (1997).

187. *Id.* at 549-50, 940 S.W.2d at 431.

> Pursuant to the *Smith* factors, investors must expect some 'benefit,' or profit, from the transaction. The Eighth Circuit Court of Appeals . . . examined the Arkansas Securities Act and determined that a fixed rate of interest payable at fixed times did not constitute the 'expectation of benefit' needed to make a note a security because it did not give the holder 'an opportunity for either capital appreciation or participation in the earnings' of the company.

Id. (citing First Fin. Fed. Sav. & Loan Ass'n v. E.F. Hutton Mortg. Corp., 834 F.2d 685, 689 (8th Cir. 1987)).

188. *Id.* at 549, 940 S.W.2d at 431.

189. Waters v. Millsap, 2015 Ark. 272, 465 S.W.3d 851 (2015).

U.S. Supreme Court has adopted.[190] The Arkansas Supreme Court declined to adopt the Family Resemblance Test because it was unnecessary to do so: the Family Resemblance Test factors are encompassed within the "flexible, all-inclusive *Schultz* test."[191]

The court deemed the *Smith* factors "instructive" but never to be relied on exclusively, instead citing the *Schultz* case to stand for the proposition that a review of all the facts is required to determine if an instrument is a security.[192] The case was remanded on the grounds that the lower court had only considered the *Smith* factors without taking into account *Schultz* and factors such as the sophistication of the parties to the transaction.[193] While the *Smith* factors are instructive, the court found "that the all-inclusive nature of the *Schultz* test is better suited to the purposes of the [Arkansas Securities] Act."[194]

C. Many Functional Cryptoassets are Likely Securities Under Arkansas Law

Under Arkansas case law, both with the line of cases using the risk capital test as well as Professor Long's five-part test, it is likely that most cryptoassets will be treated as securities regardless of whether they are pre-functional or fully functional.[195] The Arkansas courts use a broader definition of an investment contract than used by federal courts under *Howey*.[196] Though the arrangements in *Schultz* and *Casali* would most likely have been securities under the *Howey* test as well, the court specifically noted the definition of a security needed to be

190. *Id.* at 2, 465 S.W.3d at 852. Under the Second Circuit's "'family resemblance' test," an issuer can "rebut the presumption that a note is a security if it can show that the note in question 'bears a strong family resemblance' to an item on the . . . list of exceptions, . . . or convinces the court to add a new instrument to the list." Reves v. Ernst & Young, 494 U.S. 56, 64 (1990) (first citing Exch. Nat'l Bank of Chi. v. Touche Ross & Co., 544 F.2d 1126, 1137 (2d Cir. 1976); and then citing Chem. Bank v. Arthur Andersen & Co., 726 F.2d 930, 939 (2d Cir. 1984)) (alterations adopted).

191. *Waters*, 2015 Ark. at 13, 465 S.W.3d at 858.

192. *Id.*

193. *Id*. at 13, 465 S.W.3d at 858-59.

194. *Id.* at 13, 465 S.W.3d at 858.

195. *See supra* Part II.B.

196. *See infra* Part II.B.

"flexible," "liberally construed," and broad "enough to encompass the endless succession of new and innovative . . . promotional schemes."[197] The risk capital test requires neither commonality, an expectation of profits, nor that profits be solely derived from the efforts of others, so many more cryptoassets will be regulated under securities laws in jurisdictions like Arkansas using the risk capital test than those using the *Howey* test.[198]

The first prong of the risk capital test is that the offeree must furnish some initial value to an offeror.[199] The purchaser of a cryptoasset generally furnishes some value to the offeror in order to receive the cryptoasset, whether it be in the form of fiat currency or another cryptoasset.[200]

There is a notable situation where this would not be the case: airdrops. Airdrops occur when a crypto company distributes its tokens to certain user wallets for free.[201] Airdrops are done to generate awareness and create buzz around a new crypto project.[202] Since the offerees receive the tokens free of charge, they have yet to furnish any value to the offeror and thus this would fail the first prong of the risk capital test.

The second prong of the risk capital test requires that "a portion of this initial value" be "subjected to the risks of the enterprise."[203] In the case of an ICO, tokens are generally sold before they are functional because money generated in an ICO funds completion of the project.[204] This means that the purchaser assumes the risk of the business failing to properly develop a functional asset and losing the money invested.[205] Even for functional tokens, there is some level of risk involved if the token

197. Schultz v. Rector-Phillips-Morse, Inc., 261 Ark. 769, 777-78, 552 S.W.2d 4, 8-9 (1977); Casali v. Schultz, 292 Ark. 602, 605, 732 S.W.2d 836, 837 (1987).

198. *See supra* Part II.B.

199. *Schultz*, 261 Ark. at 780, 552 S.W.2d at 10 (quoting State v. Haw. Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971)).

200. Kira Egorova, *Crypto Exchanges, Explained*, COINTELEGRAPH (July 10, 2018), [https://perma.cc/F3BA-SP8M].

201. Kayalyse.io, *What Are "Airdrops" in Crypto World?*, MEDIUM (Feb. 15, 2018), [https://perma.cc/K557-FQ56].

202. *Id.*

203. *Schultz*, 261 Ark. at 780, 552 S.W.2d at 10 (citing *Haw. Mkt. Ctr., Inc.*, 485 P.2d at 109).

204. *See* BITCOIN MAG., *supra* note 103.

205. *See id.*

does not perform as promised or if something about the network does not function properly, among other concerns.[206] In either case, the value given by the offeree is subject to the risks of the enterprise, however large or small those risks may be.

The third prong requires that "the furnishing of the initial value" be "induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise."[207] This means that the purchaser of the cryptoasset must have a reasonable understanding that the benefit he or she receives from purchasing it is greater than the initial value he or she gave for it.[208] This is always met for sales involving pre-functional tokens or contractual rights to purchase tokens when completed because investors would not offer money for an incomplete project if they did not expect to gain some benefit upon completion.[209]

This third prong is likely met in situations involving functional tokens as well. Many tokens are marketed with the expectation that they can be resold at a profit, particularly when early round purchasers are given a discount from the final round price.[210] The ability to participate in the network, as tokens allow, is probably worth more to offerees and offers them some value above what they gave for the token or they would not have purchased the tokens in the first place.[211]

The fourth prong requires that "the offeree does not receive the right to exercise practical and actual control over the managerial decision[s] of the enterprise."[212] Certainly, individual

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206. *See* Park, *supra* note 121.

207. *Schultz*, 261 Ark. at 780, 552 S.W.2d at 10 (quoting *Haw. Mkt. Ctr., Inc.*, 485 P.2d at 109).

208. *See id*. at 782-83, 552 S.W.3d at 11; *see also Haw. Mkt. Ctr., Inc.*, 485 P.2d at 110.

209. *See* Muhammed Kus, A Critical Review of U.S. Securities Laws and the Status of Initial Coin Offerings: Potential Solutions for Issuers 31 (Dec. 2018) (L.L.M. thesis, Maurer School of Law, Indiana University) (on file with the Jerome Hall Law Library, Indiana University).

210. *See* Cryptonite, *How to Profit from Cryptocurrency*, HACKERNOON (Apr. 20, 2019), [https://perma.cc/QE6B-2LMG].

211. *See* Kus, *supra* note 209, at 27.

212. *Schultz*, 261 Ark. at 780, 552 S.W.2d at 10 (quoting *Haw. Mkt. Ctr., Inc.*, 485 P.2d at 109).

purchasers of cryptoassets have no control over the programming of the platform or execution of any smart contracts.[213] The platform is created by the company launching the token, and because the networks are decentralized, once launched, individual purchasers have no practical ability to modify the arrangement.[214] If, for example, the token provides the purchaser with cloud storage or access to an internet browser with no advertisements, the token owner has no real control over the service offered; rather, the token merely gives access to that functionality.[215]

Under the *Schultz* test, there is a high probability that most cryptoassets constitute securities within its broad definition.[216] It would thus be illegal to sell those assets in Arkansas, or to Arkansas residents, without first registering the securities in Arkansas or obtaining an exemption from registration under state law.[217] While it is not certain that every cryptoasset will be a security under Arkansas law, it is also not certain that they would not be.[218] This uncertainty is a problem for entrepreneurs interested in exploring this technology.[219] If crypto entrepreneurs are looking to set up shop in a certain state, they will choose states with favorable regulatory regimes, or at the very least, states with clear regulatory regimes.[220] At this time, Arkansas has neither as its risk capital approach is much more ambiguous and amorphous than the *Howey* test used by many other states.[221] Regulatory uncertainty stifles innovation.[222] Creating an exemption for fully functional cryptoassets would provide regulatory certainty and incentivize crypto businesses to choose Arkansas.

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213. *See* Andrew Young, *Crypto Network Fundamentals*, MEDIUM (Dec. 19, 2017), [https://perma.cc/7GXM-HFEL].

214. *See id.*

215. *See id.*; *see* Park, *supra* note 121.

216. *See supra* Part II.C.

217. ARK. CODE ANN. §§ 23-42-403 to -404 (2011 & 2019). This excludes transactions that are preempted under federal law, such as transactions that are registered under federal law, or those under certain exemptions. ARK. CODE ANN. § 23-42-509 (2019).

218. *See The Risk Capital Test - List of States*, SUSTAINABLE ECONOMIES L. CTR, [https://perma.cc/S3VB-6TEN] (last visited Sept. 16, 2020).

219. *See* Park, *supra* note 121.

220. *See infra* Part III.A.

221. *See supra* Part II.B.

222. *See* Jeff, *US Regulatory Uncertainty is Stifling Innovation - Fact or Fiction?*, HACKERNOON (Aug. 8, 2019), [https://perma.cc/8T6J-W877].

Wyoming resolved the risk that such cryptoassets would be tokens under the Wyoming risk capital test, and provided regulatory certainty to entrepreneurs, by adopting a formal exemption from the securities registration requirement.[223] Cryptoassets continue to be subject to state anti-fraud laws, but the uncertainty as to whether it is necessary to find an exemption from the state registration requirements is resolved.[224]

D. Arkansas's Activity Regarding Cryptoassets

1. Arkansas Securities Department No-Action Letters

On July 18, 2018, the Arkansas Securities Department issued a No-Action Letter to CEX.IO LTD which stated that staff would not recommend that the Department take an enforcement action against the company if it did not seek a license under the Arkansas Uniform Money Services Act (UMSA).[225] CEX.IO LTD, a crypto exchange established in 2013 and available in forty-three states, "make[s] fiat-to-crypto transactions accessible by offering card payments and bank transfers to the[ir] clients."[226]

On September 5, 2018, the Arkansas Securities Department also issued a No-Action Letter to Bucket Technologies, Inc. (Bucket) which stated that staff would not recommend that the Department take an enforcement action against the company if it did not obtain a UMSA license.[227] Bucket is "a digital piggy bank platform" that integrates with existing point-of-sale systems at retail locations to facilitate coinless cash transactions.[228] Bucket uses blockchain software and is free to retailers.[229] Upon customer request, it allows the cashier to press a button that says

223. SUSTAINABLE ECONOMIES L. CTR, *supra* note 218; H.B. 0070, 64th Leg., Budget Sess. (Wyo. 2018); H.B. 0062, 65th Leg., Gen. Sess. (Wyo. 2019).

224. Wyo. H.B. 0062.

225. CEX.IO LTD, Ark. Sec. Dep't No-Action Letter No. 18-NA-0006 (July 18, 2018), [https://perma.cc/VW65-YKSG].

226. *About Us*, CEX.IO, [https://perma.cc/3NGK-YWQ4] (last visited Sept. 16, 2020).

227. Bucket Technologies, Inc., Ark. Sec. Dep't No-Action Letter No. 18-NA-0003 (Sept. 5, 2018), [https://perma.cc/7LC4-GVKQ].

228. *Bucket Technologies*, CRUNCHBASE, [https://perma.cc/HT6C-RMAP] (last visited Sept. 16, 2020).

229. Kim Souza, *The Supply Side: Bucket Technologies Ready for Retail by Mid-January*, TALK BUS. & POL. (Jan. 3, 2019), [https://perma.cc/Q379-3Z74].

"bucket the change" and give a receipt with a QR code that can be scanned on a phone to access the customer's account.[230] The customer can then transfer the funds to his or her bank account once he or she has "bucketed" fifty dollars.[231]

2. Previous Legislation

As of early 2020, the Arkansas legislature has passed only one law regarding blockchain technology.[232] Act 1061 of 2019, "An Act Concerning Blockchain Technology; and for Other Purposes," amends the Uniform Electronic Transactions Act (UETA) to include records obtained via blockchain technology.[233] This Act says that signatures "secured through blockchain technology" are "considered to be in electronic form and an electronic signature."[234] It also says "[a] record or contract that is secured through blockchain technology" is "considered to be in electronic form and an electronic record," and that "[a] smart contract shall be considered a commercial contract" and "shall not be denied legal effect, validity, or enforceability."[235]

This Act has been highly criticized. An American Bar Association article over the law, titled *Another Bad Blockchain Bill*, commented that "[u]nlike a computer program, [Act 1061] defies logic."[236] This article's criticism of the Act points out that claims made about blockchain technology within the Act are untrue, no actual existing blockchain meets the blockchain definition in the Act, signatures and records stored on a blockchain already meet the UETA definitions, and no smart contract meets the smart contract definition in the Act, among other deficiencies.[237] Andrew Hinkes, a nationally recognized attorney for cryptocurrency-related legal issues, and one of

230. *Id.*

231. *Id.*

232. Heather Morton, *Blockchain 2019 Legislation*, NAT'L CONF. OF STATE LEGISLATORS (July 23, 2019), [https://perma.cc/DK6P-BPTB].

233. H.B. 1944, 92nd Gen. Assemb., Reg. Sess. (Ark. 2019); ARK. CODE ANN. § 25-32-122 (2019).

234. ARK. CODE ANN. § 25-32-122(b).

235. ARK. CODE ANN. § 25-32-122(c).

236. William Denny, *Another Bad Blockchain Bill*, A.B.A. (May 1, 2019), [https://perma.cc/4FW8-N8UM].

237. *Id.*

CoinDesks's Most Influential People in Blockchain in 2017,[238] tweeted "#Arkansas gives its UETA the 'bad #blockchain definition' treatment with A.C.A. § 25-32-122; no existing system fits the #blockchain definition, and now any contract is enforceable & valid if it contains a 'smart contract term' in Arkansas!"[239]

III. A WAY FORWARD - CREATING AN EXEMPTION FOR FULLY FUNCTIONAL UTILITY TOKENS

A. Wyoming - A Crypto Leader

Wyoming has been at the forefront of innovation-friendly legislative efforts in the regulation of cryptoassets. As of 2019, Wyoming has enacted at least thirteen different laws regarding cryptoassets, a space where few states have acted.[240] It is the only state with a truly comprehensive pro-crypto legal framework.[241] The benefit of adopting a pro-crypto legal framework is that it encourages technological innovation, which can lead to an influx of capital, jobs, and revenue.[242]

Wyoming has been particularly forward-thinking with its legislation providing exemptions from state securities laws for certain cryptoassets and the state has been heralded as the "Delaware of digital asset law."[243] Wyoming was also the first to legally recognize both uncertificated and certificated blockchain shares of stock.[244] When it comes to considering how Arkansas might adopt some of the same forward-looking approaches,

238. *Andrew Hinkes*, NYU STERN, [https://perma.cc/9L8Z-S2TT] (last visited Sept. 30, 2020).

239. Drew Hinkes (@propelforward), TWITTER (Aug. 15, 2019, 9:03 AM), [https://perma.cc/NTG3-FV2P].

240. Caitlin Long, *What Do Wyoming's 13 New Blockchain Laws Mean?*, FORBES (Mar. 4, 2019), [https://perma.cc/PM9R-6HG5].

241. *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

looking at whether the State's securities laws should be amended is a practical starting point.[245]

The 2018 Wyoming legislation is titled "Open blockchain tokens-exemptions."[246] It states that "a developer or seller of an open blockchain token shall not be deemed the issuer of a security" if the developer "files a notice of intent with the secretary of state, . . . the token is for a consumptive purpose," and the token was not sold to the purchaser as a financial investment.[247] In order for the token to have not been sold as a financial investment, the following attributes are important: (1) the token developer or seller must reasonably believe that the token is sold for a "consumptive purpose;" (2) at the time of sale, the token must already have a consumptive purpose; (3) the initial buyer must be prevented from selling the token until it has a consumptive purpose; or (4) the developer or seller must take "reasonable precautions" to ensure the token is not purchased as a financial investment.[248] As such, this law creates two categories of cryptoassets: those that are financial investments (which will be regulated as securities), and those that are sold for their consumptive value (which will not be regulated as securities under the state blue sky laws).[249]

The Wyoming law protects more than issuers. Persons who assist in transactions involving crypto are exempt from being treated as securities brokers or dealers if they "file[] a notice of intent with the secretary of state," they have a "reasonable and good faith belief that [the] token subject to exchange" meets the utility token exemption requirements, and they take "reasonably prompt action to terminate" a token exchange that does not meet these requirements.[250]

Wyoming's pro-crypto regulatory regime has had a noticeable effect. Dozens of limited liability companies (LLCs) have already registered in Wyoming with "blockchain" or

245. *See, e.g.*, Errol Villorente, *California Bill Seeks to Amend Securities Law to Exempt Some Cryptocurrencies*, MICKY (May. 13, 2020), [https://perma.cc/9EPW-FMCH].

246. H.B. 0070, 64th Leg., Budget Sess. (Wyo. 2018).

247. Wyo. H.B. 0070(a).

248. Wyo. H.B. 0070.

249. *See* Wyo. H.B. 0070.

250. Wyo. H.B. 0070.

"crypto" in their names.[251] Similar action in Arkansas is likely to yield similar results.

B. A Survey of Legislative Activity in Other States Exempting Utility Tokens

Montana exempted utility tokens from its state securities laws in May 2019.[252] Montana defines a utility token as a digital unit created "in response to the verification or collection of a specified number of transactions relating to a digital ledger or database; . . . by deploying computer code to a blockchain network that allows for the creation of digital tokens or other units;" or some combination of those methods.[253] It must be:

recorded in a digital ledger or database that is chronological, consensus-based, decentralized, and mathematically verified in nature, especially relating to the supply of units and their distribution; . . . capable of being exchanged or transferred between persons without an intermediary or custodian; and . . . issued to allow the holder of the digital unit access to a good or service delivered by the issuer without vesting the holder with any ownership interest or equity interest in the issuer.[254]

A token is exempt from registration if it meets the following requirements: the token's purpose is primarily consumptive; the issuer markets the token for a consumptive purpose and not a "speculative or investment purpose; . . . the issuer files a notice of intent . . . with the securities commissioner;" and the "utility token is available at the time of sale," or certain other conditions are met.[255] A "consumptive purpose" requires that the purpose of the token is "to provide or receive goods, services, or content including access to goods, services, or content."[256]

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251. Gregory Barber, *The Newest Haven for Cryptocurrency Companies? Wyoming*, WIRED (June 13, 2019), [https://perma.cc/2VZW-TFEB].

252. Jeremy Wall, *Montana: Utility Tokens Are Not Securities, Joins Colorado And Wyoming Crypto Friendly States*, INV. IN BLOCKCHAIN (May 25, 2019), [https://perma.cc/243K-4SPY].

253. H.B. 584, 66th Leg., 2019 Sess. (Mont. 2019); MONT. CODE ANN. § 30-10-105(23)(c)(ii)(A) (2019).

254. Mont. H.B. 584 § 1(23)(c)(ii)(B-D); MONT. CODE ANN. § 30-10-105(23)(c)(ii)(B-D).

255. Mont. H.B. 584 § 1(23)(a); MONT. CODE ANN. § 30-10-105(23)(a).

256. Mont. H.B. 584 § 1(23)(c)(i); MONT. CODE ANN. § 30-10-105(23)(c)(i).

If a functional token is not available at the time of sale, the following conditions must be met: "the consumptive purpose of the . . . token is available within 180 days after . . . sale or transfer; . . . the initial buyer is prohibited from reselling or transferring the . . . token until the consumptive purpose . . . is available;" and "the initial buyer provides a knowing and clear acknowledgment that the initial buyer is purchasing the . . . token with the primary intent to use the . . . token for a consumptive purpose and not for a speculative or investment purpose."[257]

There are some clear similarities between the Wyoming and Montana exemptions, primarily in classifying the exempt tokens by their consumptive purpose. Both the Wyoming exemption and the Montana exemption prevent the initial buyer from reselling or transferring the token until the consumptive purpose is available unless certain conditions are met.[258]

Colorado has also adopted similar legislation. The "Colorado Digital Token Act" justifies the exemption for utility tokens due to the "costs and complexities of state securities registration" that "can outweigh the benefits" for crypto-businesses, the regulatory uncertainties facing crypto businesses under Colorado's securities laws, and to promote the formation and growth of local companies and jobs.[259] The exemption requires that the issuer "file[] a notice of intent with the securities commissioner," the primary purpose of the token be consumptive, the token issuer markets it for a consumptive purpose rather than for a "speculative or investment purpose," and "the consumptive purpose of the . . . token is available at the time of sale," or certain conditions must be met.[260] If the consumptive purpose is not available at the time of sale, it must be available within 180 days of sale or transfer, the initial buyer cannot transfer or resell the token until the consumptive purpose is available, and the initial buyer must provide "a knowing and clear acknowledgment" that he or she is purchasing the token "with the primary intent to use

257. Mont. H.B. 584 § 1(23)(a)(iv); MONT. CODE ANN. § 30-10-105(23)(a)(iv).

258. *Compare* Mont. H.B. 584 § 1(23)(a)(iv) *and* MONT. CODE ANN. § 30-10-105(23)(a)(iv) (2019) *with* H.B. 0070 § 1(a)(iii)(B), 64th Leg., Budget Sess. (Wyo. 2018).

259. S.B. 19-023 § 1(2)(b-c) (Colo. 2019) (codified at COLO. REV. STAT. § 11-51-308.7 (2019)).

260. Colo. S.B. 19-023 § 1(c)(3).

the . . . token for a consumptive purpose and not a speculative or investment purpose."[261]

Arizona's legislation exempted certain "[v]irtual coin offering[s]" from state securities laws, defining "virtual coin" as "a digital representation of value that can be digitally traded and that functions as a medium of exchange, unit of account and store of value."[262] The exemption does not apply to coins marketed as an investment or coins that do not grant the coin purchaser "the right to use, contribute to the development of or license the use of a platform using blockchain technology . . . including a license to use a product or service on the platform or a discount against fees for use of the platform" within ninety days of receiving the coin.[263]

C. An Arkansas Exemption

The Arkansas legislature should adopt an exemption akin to those adopted in Wyoming, Montana, and Colorado. The Montana and Colorado legislatures use a narrower definition of a security than Arkansas and yet those states found it necessary to create an exemption for utility tokens.[264] If states that use a narrower definition of an investment contract than Arkansas

261. Colo. S.B. 19-023 § 1(c)(3)(V).

262. ARIZ. REV. STAT. ANN. §§ 44-1801(31), -1844(G) (2018).

263. ARIZ. REV. STAT. ANN. § 44-1801(32)(b).

264. "In a recent conversation with Montana State Auditor Matt Rosendale and Deputy Securities Commissioner Lynne Egan, both echoed the *Howey* test as the standard the state would use to determine whether a virtual currency would fall under the scrutiny of Montana securities laws." Jerrod Bevan & Crowley Fleck, *How Much Do Lawyers Need to Know About Bitcoin?*, MONT. LAW., Apr. 2018, at 12, 15.

> [I]n the Colorado state courts, unlike the Tenth Circuit, the test for an investment contract may be *more* demanding. The element of 'common enterprise' may be more difficult to satisfy because it may require: (1) more than the involvement of a third party; and (2) a benefit derived from the involvement not only of a third party, but other investors as well. . . . [T]he Colorado Securities Act parallels the federal securities acts and the state courts follow the federal circuits in the interpretation of the language of the state and federal acts.

S. Scott Lasher & Eric B. Liebman, *The Application of SEC v. W.J. Howey Co. in Colorado and Other Jurisdictions*, COLO. LAW., June 2002, at 73, 77 (emphasis added).

found it necessary to exempt utility tokens, it is certainly necessary in Arkansas, which uses the broad risk capital test.[265]

This Comment suggests that Arkansas should exempt fully functional cryptoassets, rather than simply "utility tokens." As mentioned previously, utility tokens that are not fully functional may, and probably do, constitute securities, even under the *Howey* test, and simply labeling something a "utility token" does not mean it is not also a security.[266] Arkansas courts look at the "economic reality" of an arrangement rather than labels to determine if the securities laws apply, and would do so in the crypto context as well.[267] Including functionality as a requisite for exemption provides greater certainty as to which tokens are exempt and greater protection for consumers as pre-functional tokens typically are sold based on speculative future increases in value.[268] "Crypoassets" is a term intended to be broader than the term "utility tokens," as used in the other exemptions, thereby providing exemptions for a greater number of crypto companies.[269]

Arkansas is poised to become a more business-friendly state, and creating this exemption is consistent with the policy goals of the state in 2020.[270] In 2019, Arkansas Governor Asa Hutchinson created the Arkansas Innovation Council to develop and expand Arkansas's "technology-driven economy."[271] Arkansas was the first state to pass a comprehensive law requiring public and charter high schools to offer computer science classes.[272] There was a 160.3% increase in Arkansas students receiving computer

265. Schultz v. Rector-Phillips-Morse, Inc., 261 Ark. 769, 780, 552 S.W.2d 4, 10 (citing State v. Haw. Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971)).

266. "ICOs, or more specifically tokens, can be called a variety of names, but merely calling a token a 'utility' token or structuring it to provide some utility does not prevent the token from being a security." SEC, *supra* note 114; *see also supra* Part I (F)-(G).

267. *See* Casali v. Schultz, 292 Ark. 602, 605-06, 732 S.W.2d 836, 838 (1987).

268. *See* BATIZ-BENET ET AL., *supra* note 116, at 11.

269. *See supra* text accompanying note 3.

270. *Governor Announces Arkansas Innovation Council to Expand State's Knowledge-Based Economy*, TALK BUS. & POL. (Feb. 12, 2019), [https://perma.cc/J3WL-FXZN].

271. *Id.*

272. Issie Lapowsky, *So, Arkansas Is Leading the Learn to Code Movement*, WIRED (Mar. 28, 2015), [https://perma.cc/NP8T-D374].

science degrees from 2014 to 2018.[273] Arkansas is also ranked third for the lowest cost of doing business.[274]

Arkansas has the potential to become a technology hub and lawmakers are taking action to attract tech companies and grow tech talent within the state.[275] Creating an innovation-friendly environment for crypto companies is consistent with the positive changes that are already taking place. States that have exempted utility tokens have already seen the positive results, as they have increased their ability to attract crypto businesses to their state.[276] In a state committed to developing tech talent, legislation that will attract blockchain businesses should be a priority.

CONCLUSION

Arkansas has a lot of work to do to move up the list from being the forty-fourth best state for technology and innovation with a grade of "F," but exempting fully functional cryptoassets from Arkansas securities laws is a small yet significant step towards doing so. This is a step towards transforming Arkansas into a crypto-friendly state and a necessary change for creating a comprehensive, innovation-forward regulatory framework for cryptoassets. The tides are already turning as other states are adopting similar legislation, and Arkansas should act while it is still early enough to retain the benefits of being a leader in this space.

273. *Tech Industry Report*, ARK. INC. 5, [https://perma.cc/8RB5-7ZFK] (last visited Sept. 17, 2020).

274. *Id.* at 17.

275. TALK BUS. & POL., *supra* note 270.

276. Barber, *supra* note 251.